Supreme Court, U. S.
FILED
NOV 16 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

SHELL OIL CO., ET AL.,
Respondents.

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF PETITIONER CONSUMER ENERGY COUNCIL OF AMERICA

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November 16, 1978

THE CASILLAS PRESS, INC.—1717 K Street, N. W.—Washington, D. C.—223-1220

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BRIEF OF PETITIONER CONSUMER ENERGY COUNCIL OF AMERICA 1/

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. A, pp. 1a-10a,

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1/ Consumer Energy Council of America is the successor organization (footnote continued)

is reported at 566 F.2d 536. Order 539-B of the Federal Power Commission, which is the order reviewed by the court of appeals, is reproduced at Pet. App. B, pp. 11a-29a. 2/

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1978. A petition for certiorari was filed on May 20, 1978. The Court granted the petition, along with a petition of the Federal Energy Regulatory Commission, on October 2, 1978, and consolidated the two cases. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission is precluded by the "production and gathering" exemption contained in Section 1(b) of the Natural Gas Act from enforcing in accordance with an appropriate standard, producer delivery obligations under certificates of public convenience and necessity issued pursuant to Section 7 of the Act.

(footnote continued)
to Petitioner Consumer Federation of America's Energy Policy Task Force.

2/ The court of appeals opinion and Order 539-B can also be found as an appendix to the Federal Energy
(footnote continued)

2. Whether the "prudent operator standard" constitutes a proper measure for enforcing producer delivery obligations under certificates of public convenience and necessity.

STATUTES INVOLVED

Section 1(b), 4(d), 7(b), 7(c) and 7(e) of the Natural Gas Act, 15 U.S.C. § 717(b), § 717c(d), § 717f(b), § 717f(c), and § 717f(e), are, in relevant part, reproduced in Appendix A, infra, pp. A1-A3.

STATEMENT

The two petitions for certiorari, one filed by Consumer Federation of America's Energy Policy Task Force, the Consumer Energy Council of America's predecessor organization ("petitioner"), and the other by the Federal Energy Regulatory Commission ("Commission" or "FERC"), pose critical questions about the Commission's jurisdiction and, more importantly, about the Commission's

(footnote continued)
Regulatory Commission's petition, although the pagination differs slightly.

responsibility to adopt effective measures in order to assure consumers an adequate and reliable supply of gas under delivery arrangements certificated pursuant to § 7(c) of the Natural Gas Act, 15 U.S.C. § 717f(c). These issues, revolving around Order 539-B promulgated by the Federal Power Commission 3/ in July of 1976, should not, and cannot, be considered as abstract questions under the Natural Gas Act. The validity of the approach set forth in Order 539-B must be considered in the context of events transpiring since the late 1960's, from the growing shortages in natural gas deliveries to the recently passed Natural Gas Policy Act. It is this context which, we submit, underscores Order 539-B's legal failings, both in its selection of a standard governing producer delivery obligations and in its establishment of an enforcement mechanism. Although the Court has in recent years demonstrated its awareness of, and sensitivity to the problem of declining gas supplies, see, e.g., FPC v. Transcontinental Gas Pipe Line Corp., 423 U.S. 326, 334

3/ On September 30, 1977, the FPC ceased to exist and its functions were transferred to the Federal Energy Regulatory Commission. Department of Energy Organization Act, Pub. L. 95-91, 91 Stat. 565, and Executive Order No. 12009, 42 Fed. Reg. 46267 (Sept. 15, 1977).

(1976); Mobil Oil Corp. v. FPC, 417 U.S. 283, 331 (1974); FPC v. Louisiana Power & Light Co., 406 U.S. 621, 626 n.2 (1972), an overview of the historical setting of the problem nevertheless seems appropriate.

1. Historic Supply and Consumer Reliance

The issuance of Order 539-B and the deliberations of the court of appeals below arose in a context virtually unprecedented in the history of natural gas regulation: a severe natural gas shortage. From the passage of the Natural Gas Act in 1938 until only a few years ago, the primary focus of Commission regulation had been on the price consumers would pay for gas transported in interstate commerce. The adequacy of supply was seldom at issue; in fact, the market for natural gas was a buyer's market, 4/ and, if anything, there was a clear surplus of useable gas, at low prices in both the interstate and intrastate markets.

As a result of this abundance, there developed an enormous investment in, and reliance upon, gas

4/ Federal Power Commission, National Gas Survey, Vol. I, p. 114 (1975).

supplies committed to the interstate market. Thus, by 1976, well after the supply picture had changed markedly, nearly 45 million customers had come to rely upon the services of the gas utility industry, 5/ and of the nation's total energy consumption, natural gas represented 27.3 per cent, exceeded only by oil which (including transportation) represented 47.2%. 6/ The extent of this reliance did not go unnoticed by the Federal Power Commission. In a 1975 report, the FPC pointed out that "the events of the past year have illustrated in dramatic and unmistakable terms the alarming degree to which this Nation's economic and social welfare are dependent upon assured and adequate energy supplies." 7/ The report went on to note that over "84 percent of the U.S. population lives in communities served with gas." 8/ Industrial reliance was also substantial -- due to major investments of capital, pollution-control considerations and, in some cases,

5/ American Gas Association, Gas Facts 1976 Data, 1, 69 (1977).

6/ Id. at 61.

7/ Federal Power Commission, National Gas Survey, Vol. I, p. 6 (1975).

8/ Homeowners' investment in gas
(footnote continued)

the lack of a suitable substitute fuel. 9/ In short, a nationwide network of interrelated obligations, investments and economic and social well-being had developed in reliance upon commitments of natural gas to the interstate market.

In the early 1970's, however, the supply picture changed dramatically, as deliveries to the interstate market began to dwindle. 10/ This altered situation required the FPC for the first time to focus its regulatory tools on assuring fulfillment of existing delivery obligations and on allocating the declining supply among competing uses. The need for action was enhanced by a widening gap between the price of gas in the unregulated intrastate

(footnote continued)
appliances alone exceeds $20 billion. Id. at 50.

9/ Id. Industrial use accounted for over 41.4 percent of total natural gas consumption in 1976, and was the largest single sector among consumers of natural gas for that year. American Gas Association, Gas Facts 1976 Data at 62, Table 50 (1977).

10/ Subcomm. on Oversight and Investigations of the House Comm. on Interstate and Foreign Commerce,
(footnote continued)

market and that in the regulated interstate market. This gap created an incentive for producers not to deliver all available gas to the interstate market, but to sell that gas instead in the intrastate market or conserve it in hope that deregulation, or FPC action on rates, would raise the price producers could charge for interstate sales. 11/

At the receiving end of the chain of distribution, the FPC responded to the shortage with its curtailment program. Flatly stating that the

(footnote continued)
Federal Regulation and Regulatory Reform, H.R. Doc. No. 95-134, 95th Cong., 1st Sess. 385-88 (1976). See also FPC Staff Report No. 2, National Gas Supply and Demand 1971-1990 (1972): "The emergence of a natural gas shortage during the past two years marks an historic turning point -- the end of natural gas industry growth uninhibited by supply considerations." Id. at xi.

11/ FPC data reflect the growing shortage and the incentive created by the disparity between interstate and intrastate rates. For example, during this period, curtailments of interstate service rose rapidly, while producers dedicated an ever larger proportion of newly found reserves to the intrastate
(footnote continued)

curtailment provisions in the pipeline-utility contracts were "incompatible with consumer protection" in times of shortage, the FPC directed curtailment in the manner it felt would best serve the public interest. FPC Order 467, 49 FPC 85, 86, 38 Fed. Reg. 1503, 1504 (Jan. 8, 1973). See also, FPC v. Louisiana Power & Light Co., 406 U.S. at 646.

By contrast, the FPC was slow to take any measures to assure that producers maintained their deliveries from fields which were already dedicated to interstate commerce under FPC certificates. 12/ It was

(footnote continued)
market. Thus, cumulative firm curtailments in the interstate market grew from 17,535,000 Mcf in 1970 to 3,181,903,600 Mcf in 1976. See FPC Bureau of Natural Gas Staff Report, Report on Monthly Curtailments Based on FPC Form No. 17, Schedule II, sheets 2-4 (June 1977). Similarly, the interstate market's share of new reserve additions fell from 68% in 1966 to 13% in 1975, while intrastate additions rose correspondingly from 32% to 87%. FPC Opinion No. 770-A Nov. 5, 1976, at 116.

12/ See, e.g., Hearings on the Availability of Natural Gas Supplies
(footnote continued)

not until October of 1975, that the FPC turned finally to defining and enforcing producer delivery obligations under the Act.

2. Order 539-B Proceedings and Court Review

The FPC issued Order 539 on October 14, 1975. 13/ In its

(footnote continued)
Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 1st & 2d Sess. at 28 (1976).

During this period, the FPC undertook only one meaningful enforcement action to counter flagging deliveries. See Gulf Oil Corp. v. FPC, 563 F.2d 588 (3d Cir. 1977), cert. denied, 98 S.Ct. 1235 (1978). The potential results of concerted enforcement efforts are well demonstrated by the fact that following firm FPC action, Gulf's deliveries from April 1977 through March 1978 were 6,250,000 Mcf in excess of its certificate obligation, as compared, for example, to a shortfall of over 16,000,000 Mcf from November 1976 through February 1977. See Gulf Oil Corporation, Supplemental Statement Reflecting Refund and Interest, Docket No. CI 64-26, filed May 3, 1978, with the Federal Energy Regulatory Commission.

13/ Order No. 539, 40 Fed. Reg. 49571
(footnote continued)

preamble to Order 539, the FPC acknowledged that the order was issued in answer to recurring questions raised during Congressional hearings concerning the deliverability obligations of natural gas producers. R. 147. 14/ The FPC then stated that it had been and continued to be the Commission's policy:

> to enforce all delivery and supply obligations of jurisdictional natural gas producers and jurisdictional natural gas pipelines, as they may be occasioned by applicable regulations of the Commission and the statutory standards of the Natural Gas Act, which govern -- and, therefore, which are incorporated within -- the certificates for all certificated arrangements authorized pursuant to the Act. R. 148.

(footnote continued)
(Oct. 23, 1975) R.147-58. Order 539 and the subsequent Order 539-A can also be found in the Joint Appendix, to be filed in this case. It is our understanding that the Joint Appendix will also reflect the page numbers from the record.

14/ See Congressional reports cited in Order 539, n. 1. R.147-48.

In so announcing its policy, the FPC also made clear that certificates imposed obligations on natural gas companies extending beyond the terms of the individual contract between the producer and pipeline. R.152. To aid in carrying out its policy, the FPC added a new section, § 2.83, to the General Policy and Interpretations in Title 18 of the Code of Federal Regulations. In subsection (a) of § 2.83, the FPC stated that natural gas producers must comply with all "deliverability or production of natural gas requirements to meet . . . certificated operations, services, developments, quantities, volumes, or sales." (Emphasis added.) R.155. Subsection (d) of § 2.83 then set forth specific terms to be included in all future certificates, imposing on the certificate holder the obligation to report the results of any reserve determination or redetermination, and explicitly providing that the producer had a "certificated delivery obligation" to be determined by reference to the contract provision, as modified by the certificate, and to remain in force unless a change were authorized by the FPC, based upon the certificate holder's documentation of the reasons for the change. R.157.

The issuance of Order 539 brought forth a storm of protest from the

producers, in the form of applications for rehearing and reconsideration. The producers claimed that Order 539's enforcement policy would run afoul of the "production and gathering" exemption contained in Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), and that it represented a fundamental misunderstanding of the nature of producers' obligations. See R.170, 310, 326, 355. In response to those protests, the FPC issued Order 539-A on March 26, 1976. 15/ While purportedly defending the position set forth in Order 539, Order 539-A in fact reflected a significant retreat from the FPC's previous position on delivery obligations, shifting the focus from the Natural Gas Act and the certificates issued under it, to the private contract entered into between the producer and the pipeline. Thus, the FPC stated that in its earlier Order 539, it had intended to inform producers that once deliveries were commenced in interstate commerce under certificated arrangements, "such deliveries continue without unjustifiable unilateral interruption in accordance with the applicable provisions of the contract." (Emphasis added.) R.398. 16/

15/ Order 539-A, 41 Fed. Reg. 14531 (Apr. 6, 1976), R.394.

16/ See also similar characterization at R.395.

The FPC also gave notice in Order 539-A of a rulemaking proceeding designed to gather information concerning the obligation of "parties accepting a certificate of public convenience and necessity from this Commission," and of its intention to amend § 2.83 accordingly. R.403. In these subsequent proceedings, the producers reiterated their earlier claim that FPC enforcement would violate § 1(b) of the Natural Gas Act. 17/ And in response to the FPC shift of direction from the certificate to the contract, the producers replied that, by and large, the underlying producer-pipeline contract contained no firm delivery obligations. Rather, the producers asserted that under their contracts they retained "sole discretion" regarding the rate of delivery. 18/ Petitioner, for its

17/ See, e.g., R. at 178, 314, 360-61, 371-80, 655-56, 661-68, 669, 24-25.

18/ See, e.g., R. at 175, 312-13, 364-65, 660-61, 669, 20, 29, 68, 74. There is no evidence in the record that the FPC ever investigated this claim. In briefing before the court of appeals, petitioner made an effort to review a cross section of producer-pipeline contracts and found a substantial variation, with some containing "sole discretion" terms (footnote continued)

part, urged the FPC to return to the policy set forth in Order 539 -- that certificate obligations take precedence over contract terms -- and to measure the certificate obligation by the level of service actually provided. Alternatively, petitioner suggested that the obligations might be determined by reference to various representations made in the course of producer or pipeline certifications. 19/

(footnote continued) and others containing firm obligations, often building in adjustments based on reserve determinations. Brief for Petitioner, Consumer Federation of America, at 20-23. If any generalization can be made on the basis of this sample, it is that more recent contracts give producers more discretion, probably reflecting their prevailing bargaining power in days of shorter supply.

19/ At the time of certification, a producer applicant must submit its gas supply contract and a map of the dedicated field. 18 C.F.R. § 157.25. The pipeline applicant must also submit detailed estimates of gas deliverability and proved reserves. 18 C.F.R. 157.14(a)(10). Deliverability, for these purposes:

> represents the number of future years during which

(footnote continued)

Following the hearing, on July 30, 1976, the FPC issued Order 539-B to "clarify" its prior orders. Pet. App. B, p. 22a. Despite the fact that the notice of rulemaking provided by Order 539-A had indicated a purpose simply to "amend" § 2.83 of the FPC's General Policy and Interpretations, Order 539-B repealed that section entirely, including the reporting and approval requirements found in § 2.83(d). Pet. App. B, p. 22a. In its place, the FPC enacted a new section -- § 157.41 -- of its Regulations. Pet. App. B, p. 23a.

With this abrupt change, the FPC abandoned entirely the approach set forth in § 2.83 which focused upon the Act, and the duties imposed

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(footnote continued)

a pipeline company can meet its annual requirements for its presently certificated delivery capacity from presently committed sources of supply. The availability of gas from these sources of supply shall be governed by the physical capabilities of these sources to deliver gas, by the terms of existing gas purchase contracts and limitations imposed by state or federal regulatory agencies.

29 Fed. Reg. 4874 n.1 (Apr. 7, 1964).

under it; instead the agency endorsed the contract between the producer and pipeline as establishing the contours of certificated obligations, and imposed a further contract concept -- "prudent" operation. Pet. App. B, p. 17a. The Order stated that the prudent operator standard was adopted not because it reflected producer service obligations stemming from the certificates, but essentially because it was a standard with which producers were "acquainted," from their own private lease arrangements and from state and federal laws relating largely to conservation. Pet. App. B, p. 17a.

Immediately following issuance of Order 539-B, Shell Oil Company petitioned for review in the Fifth Circuit. Petitioner filed a petition for review in the D.C. Circuit, which promptly transferred the action to the Fifth Circuit pursuant to 28 U.S.C. § 2112. Oral argument was held before the court of appeals on July 6, 1976. On January 20, 1978, the court of appeals issued its opinion, declaring Order 539-B's prudent operator standard invalid, as contravening the jurisdictional exemption for production and gathering activities contained in Section 1(b) of the Natural Gas Act. Although recognizing that under prior holdings of this Court the Commission has jurisdiction to "enforce 'service

obligations' contained in certificates that it issues to producers [in order to prevent] producers from ceasing deliveries from fields . . . capable of continuing production," Pet. App. A, p. 7a, the court concluded that Order 539-B "clearly is intended to open the door to FERC involvement into forbidden production activities." Pet. App. A, p. 9a. In so holding, the court of appeals did not explain how the Commission might effectively exercise its admitted certificate enforcement powers.

3. Impact of the Natural Gas Policy Act

Since the issuance of Order 539-B and the decision of the court of appeals, Congress has passed, and the President has signed, new legislation designed to bring about the phased deregulation of certain categories of natural gas. Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621. Briefly summarized, the NGPA withdraws from the Commission's jurisdiction under the Natural Gas Act all natural gas which was not committed or dedicated to interstate commerce as of the day before the date of enactment of the NGPA. However, with the exception of limited categories of already dedicated gas which might qualify

as "new" gas under the NGPA, 20/ all natural gas presently dedicated to interstate commerce remains within the jurisdiction of the Commission, under a statutory pricing mechanism tied to the Commission's current "just and reasonable" rates.

The total volume of gas remaining in these dedicated gas reserves was estimated at the close of 1976 to be 98.3 trillion cubic feet, nearly nine times the amount of gas delivered from those reserves during

20/ In the context of the instant case, the most significant of these categories are "new natural gas" and "natural gas produced from any new, onshore production well." The category of "new natural gas," NGPA § 102, includes any gas produced from a new well which is drilled 2.5 miles or more away from the nearest well which produced gas in commercial quantities between January 1, 1970 and April 20, 1977. The category of gas produced from "new, onshore production wells," NGPA § 103, includes any gas from a new well located onshore, surface drilling of which commenced on or after February 19, 1977, which satisfies State and federal wellspacing requirements, if any, and which is not located within certain "proration units" (i.e., portions of a reservoir which will be effectively and efficiently (footnote continued)

the preceeding year. 21/ Moreover, a FERC analysis submitted to the Senate Committee on Energy and Natural Resources during Congressional deliberations stated:

> The bulk of gas which will serve interstate consumers is in the [already dedicated or committed] category, and will remain subject to the Commission's nonprice jurisdiction. 22/

(footnote continued)
drained by a single well).
For a description of the resulting rate structure, see n. 23, p. 21, infra.

21/ FERC, The Gas Supplies of Interstate Natural Gas Pipeline Companies 1976, at 3, 6-7 (1978).

22/ Letter of Charles B. Curtis, Chairman, FERC, to Senator Henry M. Jackson, Chairman, Senate Committee on Energy and Natural Resources (Sept. 8, 1978), attached analysis at 86. See also Department of Energy Division of Oil and Gas Analysis: Office of Energy Source Analysis, Analysis Memorandum AM/ES/7801: Revenues to Natural Gas Producers Under Alternative Regulatory Assumptions, at 24-25 (June 12, 1978)(hereinafter "DOE Memorandum"); 124 Cong. Rec. at
(footnote continued)

The sheer volume of dedicated gas which remains subject to Commission jurisdiction under the Natural Gas Act shows the need for an unequivocal affirmation by this Court of the Commission's authority to assure delivery of that gas.

The need for such an affirmation is enhanced by the pricing system imposed by the NGPA. That system provides a mechanism for establishing the price of various categories of gas, "new" and "old," interstate and intrastate. The statutory rates for "old" gas are largely derived from present regulated rates. Ceiling prices for "new" gas and sales under existing intrastate contracts, by contrast, are substantially higher. 23/ And as of January 1, 1985, price ceilings will be eliminated totally for most categories of natural gas, with the exception of "old" gas. NGPA § 121.

(footnote continued)
H13239, H13243 (Oct. 14, 1978) (Congressional Budget Office estimated only 3% increase in production by 1985 as a result of NGPA).

23/ Therefore, for "new natural gas," NGPA § 102, the maximum price is calculated by establishing a $1.75 base price for April 1977, and increasing it by both a monthly inflation adjustment factor and an annual escalator of 3.5 or 4 percent.
(footnote continued)

While the NGPA is thus clearly designed to assure that consumers continue to benefit from the lower prices attached to presently dedi-

(footnote continued)
"New, onshore production well" gas, NGPA § 103, is increased from an April 1977 level of $1.75 by means of a monthly inflation factor only. However, gas dedicated to interstate commerce before the date of enactment not only starts at a lower "base rate" for April 1977 (i.e., generally the base rate is the "just and reasonable" rate previously set for such gas by the Commission), but also is increased only by a monthly inflation factor. As a result, the estimated maximum ceiling prices for these three categories as of October 1978 would be $2.07 (new natural gas), $1.97 (new, onshore) and either $1.63, $1.06, or $.33 for dedicated gas. Because rates will be recomputed monthly, the gap between these categories will grow over time. FERC Office of Public Information, Fact Sheet: Natural Gas Policy Act of 1978 (1978)(attached table). See also DOE Memorandum, supra at 24-25.

cated supplies, 24/ the act itself also creates obvious incentives which, if unchecked by careful exercise of Commission power, might result in the diversion of these dedicated reserves to gradually unregulated categories, which are allowed higher ceiling prices under the NGPA. The existence of such incentives renders the need for careful consideration by this Court especially critical.

24/ See, e.g., 124 Cong. Rec. at H13242 (Oct. 14, 1978)(Statement of Rep. Sharp, Manager on part of the House in Conference Committee):

> [W]e put the highest incentive where the highest risks are and where the greatest gains might come from. The next highest incentives are where there are new gas supplies and major risks . . .
>
> We tried to see to it that we were protecting the consumer from paying the highest prices where it was not deserved. (emphasis added).

ARGUMENT

In Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954), this Court made it clear that independent producers of natural gas are subject to the Commission's jurisdiction under the Natural Gas Act. As a result, any producer who wishes to sell gas in the interstate market must obtain a certificate of public convenience and necessity from the Commission. The question in this case is what, if any, delivery obligations are imposed on a producer by and under the Act, when the producer accepts such a certificate and commences interstate service. And, if delivery obligations are so imposed, the question then is, whether and how those obligations may be enforced.

The Commission in Order 539-B would measure producer delivery obligations by a prudent operator standard. The producers have attacked this standard on both jurisdictional and substantive grounds. On jurisdictional grounds, they argue that the standard invades the production and gathering exemption in § 1(b) of the Act. On substantive grounds, they argue, in effect, that the certificates impose no independent delivery obligations, and further, that supply contracts with the pipelines contain no firm requirements as to the rate of delivery.

The Commission and petitioner, by contrast, agree that § 1(b) cannot be read to nullify all the provisions of the Act designed to assure consumers an adequate, reliable supply of gas. The Commission and petitioner also agree that the certificates impose delivery obligations separate from, and in addition to, the obligations in producer-pipeline contracts. Disagreement centers on the measure of those obligations, and the mechanism which should be adopted to enforce them.

The court of appeals invalidated the Commission's prudent operator standard on jurisdictional grounds, thus diverting attention from the underlying issue concerning the substantive obligations imposed by the Act. This threshold jurisdictional question is, of course, critically important, since a broad interpretation of the § 1(b) exemption renders discussion of standards and enforcement largely moot. We submit that the court of appeals' decision is in conflict both with the scheme and purpose of the Act, and with this Court's decisions construing the Act. We also believe, however, that the FPC unwittingly aided the producers in their jurisdictional challenge. It did so by articulating a standard which focuses directly upon the operations of the producer, rather than upon service rendered.

Had the standard focused upon service, production and gathering activity would only be of incidental concern, as a possible justification for declining deliveries. In that event, surely there could be no colorable challenge to the Com..ssion's jurisdiction.

While we do not see Order 539-B's focus on producer operations as a fatal jurisdictional flaw, we submit that the standard does otherwise violate the Natural Gas Act. It is to this substantive failing of the standard that we devote most of our attention.

The terms of Order 539-B indicate that the FPC drew the prudent operator standard from two areas of the law familiar to producers, but foreign to the purposes of the Act. As for enforcement, the Order articulates no procedures or approach. We submit that the Natural Gas Act requires more. It requires a standard reflecting the Act's fundamental concern for maintenance of service. It requires a standard that is free from vagueness, and gives producers, consumers and Commission staff concrete guidance as to the supply obligations imposed by the Natural Gas Act. And it requires a standard that is enforceable.

I. THE STANDARD GOVERNING DELIVERY OF NATURAL GAS UNDER A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY MUST REFLECT THE "SERVICE" CONCERNS OF THE NATURAL GAS ACT AND MUST BE UNAMBIGUOUS AND ENFORCEABLE.

A. Continuity Of Service Is The Key To Producers' Delivery Obligations.

Only last May, this Court reaffirmed that the fundamental purpose of the Natural Gas Act is to assure the consumer "an adequate and reliable supply of gas at a reasonable price." California v. Southland Royalty Co., 98 S. Ct. 1955, 1958 (1978). In prior years, it was perhaps sufficient for the focus of regulation to be upon the reasonableness of the price charged. Today, however, it has become clear that regulation cannot be limited to assuring reasonable rates. The focus of attention must turn from rates to supply and service, for the dual purpose of the Natural Gas Act is not fulfilled if the public receives only an inadequate or unreliable flow of gas at a reasonable price.

As this Court said in the landmark case of Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137, 155 (1960), there are "two sources of

. . . supply stability inherent in the regulatory system established by the Natural Gas Act -- the provisions of private contracts and the public regulatory power." The first source of protection for the consumer then, is the contract of the parties. This was recognized in United Gas Pipe Line Co. v. Mobil Gas Service Corp., 350 U.S. 332 (1956), where the contract of the parties established a single fixed rate, but the seller attempted to file a rate change with the Commission under § 4(d) of the Natural Gas Act, 15 U.S.C. § 717c(d). This Court held that the Natural Gas Act did not confer upon the seller the right to thus avoid its contractual obligation. So too in the instant case, it should be recognized from the outset that to the extent the private contractual undertakings of the parties provide a fixed obligation that assures the public of reliable service, that undertaking cannot be avoided.

On the other hand, this Court has long recognized that where private contractual arrangements do not assure a steady and reliable supply of gas, the terms of the Act come into play to fill the gap. Sunray Mid-Continent Oil Co. v. FPC, supra, and Sun Oil Co. v. FPC, 364 U.S. 170 (1960) so hold. Moreover, analysis of the principles which were laid down

in Sunray and Sun Oil, and confirmed recently in California v. Southland Royalty Co., supra, leads to the conclusion that continuity of service is a central concern of the Act, and that the maintenance of such service must therefore be the ultimate test of the producers' delivery obligations under certificates of public convenience and necessity.

Under § 7(c) of the Act, 15 U.S.C. § 717f(c), all natural gas companies must obtain a certificate of public convenience and necessity from the Commission before engaging in the interstate supply of natural gas. In order to obtain a certificate, an applicant must demonstrate that it is "able and willing properly to do the acts and to perform the service proposed," 15 U.S.C. § 717f(e), and to this end, a producer applicant must submit its gas supply contract. In both Sunray and Sun Oil, the producer submitted a contract of limited duration in applying for a certificate of public convenience and necessity; in each case, the FPC issued a certificate which was silent as to duration. In Sunray, the producers argued that the FPC could not issue a certificate of unlimited duration; and in Sun Oil the producers argued as well that the FPC had not issued certificates of unlimited duration. In both cases, the producers maintained that their obligations were

defined solely by their contracts, and that "the Natural Gas Act does not vest the Commission with broad powers to assure continuity of service." (Brief of Petitioner, Sunray Mid-Continent Oil Co., at 18, in Sunray Mid-Continent Oil Co. v. FPC, supra.) The FPC, by contrast, argued that the issuance of a certificate did not amount to the adoption of a contract for a specific number of years, nor to the adoption of a "sale" of a "specific volume" or "batch" of gas. Rather, the issuance of a certificate amounted to an authorization to perform a "supply service which, once started is the subject of continuing . . . regulation and may continue independently of the parties' contract." (Brief of Respondent Federal Power Commission at 15, in Sun Oil Co. v. FPC, supra (citation omitted).) Thus, there resulted a fundamental clash as to the nature of the producers' obligations and the extent of the FPC's powers under the Natural Gas Act.

This Court adopted the view urged by the Government. Despite the silence of the certificate on the issue, it was implicit in the structure and purpose of the Act that in granting a certificate, the Commission was not adopting the underlying contract but rather, was authorizing a service which would

thereafter continue subject to the Commission's supervision. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 151-56.

An important factor in the Court's analysis was section 7(b) of the Act, 15 U.S.C. § 717f(b). Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 141-43. Section 7(b) provides that "[n]o natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities" unless the Commission first determines "that the available supply of natural gas is depleted to the extent that continuance of service is unwarranted, or that present or future public convenience or necessity permit such abandonment." (Emphasis added.) The reach and purpose of § 7(b) are clear. As the Third Circuit had earlier observed in denying abandonment authorization to a producer relying upon an escape clause in the certificated contract:

> [M]ost important, service to the public was the foundation of the contract operation. That service was given. The public relied on it through the years and is entitled to its fair continuance. To abandon it there must be Commission approval. J.M.

Huber Corp. v. FPC, 236 F.2d 550, 558 (3rd Cir. 1956), cert. denied, 352 U.S. 971 (1957). (Emphasis added.)

Indeed, in Sunray, this Court too noted its concern that a " local economy which had grown dependent on natural gas as a fuel" not be suddenly left without service. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 143.

Case after case can be found to the same effect. See generally, Conine, G., and Niebrugge, T., Dedication Under the Natural Gas Act, 30 Okla. L. Rev. 735, 772-833 (1977). Most of the service cases have been decided under section 7 of the Act. However, the Natural Gas Act's concern over maintenance of service is also exhibited in another section, § 4, and in particular § 4(d), 15 U.S.C. § 717c(d). Section 4(d) provides that "[u]nless the Commission otherwise orders, no change shall be made by any natural-gas company in any . . . service . . . except after thirty days' notice to the Commission and to the public." Any such change in service is subject to review by the Commission under § 4(e), 15 U.S.C. § 717c(e).

The purpose of § 4(d) in regulating producer discretion and assuring stability and reliability is well-established in the price arena. Producer gas sales contracts invariably

include price escalation clauses. Accordingly, when in 1954, the producers were first subjected to regulation under the Act, Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954), they argued that these price escalation provisions relieved them of any duty to file for a change of rate under § 4(d). This argument was uniformly rejected by the courts. Episcopal Theological Seminary v. FPC, 269 F.2d 228 (D.C. Cir.), cert. denied, sub nom. Pan American Petroleum Corp. v. FPC, 361 U.S. 895 (1959); Bel Oil Corp. v. FPC, 255 F.2d 548 (5th Cir.), cert. denied, 358 U.S. 804 (1958); Cities Service Gas Producing Co. v. FPC, 233 F.2d 726 (10th Cir.), cert. denied, 352 U.S. 911 (1956).

Clearly, the problem of price escalation is first cousin to the problem of service de-escalation. Whereas under price escalation clauses, the producers argued that they could increase prices at will, so here, under the "sole discretion" clauses of their contracts, they now effectively argue that they can decrease service at will. 25/

25/ In light of the higher prices available for "new" gas and intrastate gas under the NGPA, a decrease in service under Commission certificates in fact allows an increase in price through the sale of noncerti-
(footnote continued)

However, in the same manner that the Act protects the public from contractually permissible price increases, so too the Act protects the public from contractually permissible service decreases. 26/ This was recognized by the Court in Sunray, supra 364 U.S. at 156:

(footnote continued)
ficated gas. See pp. 21-22 supra.

26/ It should be noted that when a contract allows flexibility to one party, and the Commission in enforcing the Act nevertheless imposes a requirement of stability, the Commission is not requiring the party to violate obligations under the contract. It should also be noted, however, that in enforcing the Act, the Commission can, if necessary, require a party to disregard contractual obligations. Indeed, the Court only recently upheld the Commission's authority to do so in the context of curtailment. See FPC v. Louisiana Power & Light Co., 406 U.S. at 646-47. See also FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956), where the Court recognized the FPC's power to authorize rate increases despite contractual limitations to the contrary. And see Permian Basin Area Rate Cases, 390 U.S. 747, 763-64 (1968), where the Commission
(footnote continued)

> [O]nce . . . dedicated, there can be no withdrawal of [a] supply of gas from continued interstate movement without Commission approval. The gas operator, although to this extent a captive subject to the jurisdiction of the Commission, is not without remedy to protect himself. That remedy he has . . . in the "change" power under § 4(d) when his contract has expired or where his contract permits its use during its term. Under a similar Act this Court has held to the same effect as we hold today. Pennsylvania Water & Power Co. v. Federal Power Comm'n, 343 U.S. 414, 423-44. 27/ (Citation omitted.)

(footnote continued)
imposed a minimum area rate which allowed producers to raise their prices notwithstanding the lower prices provided by the producer-pipeline contracts. Not surprisingly, none of the producers in Permian Basin objected to the minimum rate, even though it was inconsistent with their contracts.

27/ The Court's reference to Pennsylvania Water & Power Co. further illustrates § 4(d)'s concern
(footnote continued)

The Commission's regulations also reflect the scope of § 4(d). Thus, under 18 C.F.R. § 154.94(a), no change in "service" can be made without filing a change in rates pursuant to § 4(d) of the Act. And pursuant to 18 C.F.R. § 154.94(c):

> (c) The operation of any provision of the rate schedule providing for future or periodic changes in . . . service . . . shall constitute a change in rate schedule.

(footnote continued)
with maintenance of service, absent approval of declining deliveries. In that case, in construing § 205(d) of the Federal Power Act, 16 U.S.C. § 824d, a section almost identical in wording to section 4(d) of the Natural Gas Act, this Court stated that "[i]f Penn Water wishes to discontinue some or all of the services it has rendered for the past twenty years, the Act, as the Commission pointed out, opens up a way provided Penn Water can prove that its wishes are consistent with the public interest." 343 U.S. at 423. The way for Penn Water to proceed, said the Court, was to ask permission for a change of existing services pursuant to § 205(d). Id. at 424.

It is therefore apparent that maintenance of service is at the core of the obligations undertaken by a producer in applying for a certificate of public convenience and necessity. Indeed, the view we urge here seems to follow logically from Sunray and Southland Royalty Co. Surely it would have made little difference if Sunray or Southland, rather than attempting to cease interstate deliveries from dedicated reserves, had simply cut those deliveries by half. Nor, we submit, would their positions have been enhanced if they had pointed to a "sole discretion" clause in the delivery contract. In either case, we believe the Court would have focused directly on prior service and required the Commission to regulate any effort to curtail that service.

B. The Prudent Operator Standard Is Invalid Because It Is Not A Service-Oriented Standard.

Given, then, that service is the central theme of the Natural Gas Act in this area, and that the Commission has both the power and the concomitant duty to protect the public from unwarranted reductions in service, where does Order 539-B go wrong? The Order speaks of service. It faithfully cites the

sections of the Act relating to service, as justification for the standard adopted. Pet. App. B, pp. 13a, 15a, 16a. It is thus well cushioned in all the right language. Yet, notwithstanding this litany, the standard does not look to service rendered in determining the producer's continuing obligation. Rather, the standard is based on concepts which bear no relation to service. 28/

As the FPC indicated, Pet. App. B, pp. 16a, 17a, the prudent operator standard is derived essentially from two sources: first, the law governing the relation between the producer and the owner of the land from which gas is extracted; and second, state and federal laws which relate largely to conservation. 29/ Neither

28/ Indeed, in describing the actual operation of the prudent operator standard, the FPC made no further mention of "service." Pet. App. B, pp. 16a-18a. Moreover, the Order wholly ignores the procedures under the Act for enforcing producers' service obligations, § 4(d), § 4(e) and § 7 (b). 15 U.S.C. §§ 717c(d), 717c(e), 717f(b).

29/ Although the Order also states that the FPC has historically reviewed natural gas companies' actions on the basis of prudence, its sole citation for this proposition is FPC (footnote continued)

source is concerned with assuring that consumers receive an adequate and reliable supply of gas. Indeed, it can be demonstrated that both these areas of the law are designed to serve purposes distinct from, and in large measure, actually in conflict with the purposes of the Natural Gas Act.

Let us look first at the law governing the producer's lease agreement. A producer typically obtains the right to explore for and produce natural gas by negotiating a lease with the landowner, and paying the landowner a royalty for the gas produced from that land. An implied condition in any such lease is that the producer explore, develop, and market as a prudent operator would. The purpose of implying a prudent operator standard in this lease agreement was explained in the seminal case of Brewster v. Lanyon Zinc Co., 140 F. 801, 810-11 (8th Cir. 1905). It was to ensure that in the extraction of gas, "work should be along such lines as would be

(footnote continued)
v. Natural Gas Pipeline Co., 315 U.S. 575 (1942). Pet. App., p. 16a. That case, however, deals exclusively with the reasonableness of rates and fair returns on investment under sections of the Natural Gas Act which expressly refer to the consideration of reasonableness.

reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit." Obviously, what may be to the mutual advantage and profit of the producer and his lessor may not be to the similar advantage of users relying on the interstate transportation of gas. Indeed, the interests of the producer and his lessor may be diametrically opposed to those of the consumer.

For example, the treatise cited by Order 539-B, Pet. App. p. 16a, breaks the prudent operator standard into a number of implied covenants. See H. Williams and C. Meyers, Oil and Gas Law § 802.3 at 14.2 (1976). Among those covenants are the covenants to drill exploratory wells, to develop the premises, and to market the product. In discussing this latter covenant, in § 856.3 at 409-10, the treatise makes clear that a prudent operator may be justified in delaying the marketing of his product if he thinks he can thereby get a better price for it. The treatise then goes on to point out that "the same type of good faith judgment may be involved in a decision by the lessee to delay the execution of a gas sales contract until he can find an intrastate market, rather than an

interstate market, for the gas." Id. at 410. A standard based on such considerations is hardly tailored to ensure the interstate service certificated by the Commission and relied upon by a myriad of users.

Nor are the service ends of the Natural Gas Act furthered by resort to those state or federal laws which relate to conservation. Because of the peculiar nature of gas production, when gas is extracted too rapidly, waste may occur. See Interstate Oil Compact Commission, Oil and Gas Production, at 112-13 (1969). State and federal laws have been enacted to prevent such waste. They often set an upper limit on rates of production. They do not, however, set a lower limit. See Initial Decision in FERC Docket RI 75-112 at 83, July 7, 1978. If then, a producer had financial incentives to slow production more than would be necessary to prevent waste, these laws would provide no assistance in holding the producer to the fulfillment of his service obligation.

This is not the first time the Commission has tied its regulation to a concept totally foreign to the scheme of the Act. In FPC v. Texaco, Inc., 417 U.S. 392, 397-99 (1974), to this Court's obvious dismay, the Commission tied a supposedly

regulated rate to the going market price. What the Commission has done here is no less incongruous, for the prudent operator standard is no better designed to assure continuing service within the meaning of the Natural Gas Act than the marketplace standard was designed to assure "reasonable" rates.

The result reached by the FPC may in part be explained by the course of action it followed in arriving at the prudent operator standard. After dismissing the producers' contention that their contracts with the pipelines permit them virtually unfettered control over deliverability, Pet. App. B, pp. 13a, 14a, the Commission did not look more carefully at those contracts, 30/ or consider the relevance of past reliance upon the continuing delivery obligation. Nor did it examine the certification process to see what guidance the various undertakings or submissions there might provide in defining "certificated obligations." Instead,

30/ The Commission seems by and large to have contented itself with the producers' characterization of their contractual obligations. See, e.g., the discussion in Order 539-B regarding "minimum daily delivery obligations," where the Commission simply stated "we must conclude that
(footnote continued)

the Commission reached outside the certification process, drawing the concept of "prudent operation" from private lease agreements and laws relating to conservation. Having identified the circumstances in which this concept had been used, the Commission simply concluded that the standard was appropriate because "all producers are acquainted" with it. Pet. App. B., p. 17a. In so doing, the Commission strayed both from the purposes of the Act, and from its task of construing and enforcing the Act's terms. See Sunray Mid-Continent Oil Co. v. FPC, supra; Sun Oil Co. v. FPC, supra.

C. The Prudent Operator Standard Is Also Invalid Because It Is Vague And Unenforceable.

Perhaps because it represents a standard neither derived from nor responsive to the Act's purposes, the "prudent operator" approach is both vague and unenforceable. If, as the Commission concedes, there is a need to assure that producers meet

(footnote continued)
the clause is not one that has a generally accepted meaning among pipelines and producers."
Pet. App. B, p. 12a.

their certificated delivery obligations, the "prudent operator" standard of Order 539-B will not -- indeed, cannot -- satisfy that need. For this additional reason, it should be set aside.

The issue of vagueness must be evaluated in context. The context, as discussed earlier, is a network of pipelines, utilities and end users who depend upon a continuing supply of gas from dedicated fields, and who have made major investments in reliance upon that supply. What those users need, above all, is some precise and predictable measure of the producer's obligations. A standard of "prudence," with no specific guidance as to what factors will be relevant in its application, provides no such measure.

A standard so vague not only disregards the public's needs; it also disregards statutory intent. This would be glaringly apparent if the problem addressed had been one of price, rather than one of supply, because the FPC surely could not have discharged its duty to regulate rates by simply admonishing the producers that their prices should be just and reasonable. In fact, the FPC generally did not take its mandate to regulate rates so lightly. Rather, as the proceeding in Permian Basin illustrates, the FPC worked

hard to develop manageable ways of monitoring the producers' activities in the rate area. See Permian Basin Area Rate Cases, 390 U.S. 747 (1968). Moreover, in the one instance where the FPC did promulgate a ratemaking order that was so vague as to amount to effective price deregulation, this Court did not hesitate to overturn that order. FPC v. Texaco, Inc., 417 U.S. at 395-97.

The Natural Gas Act was intended to provide not only reasonable rates, but also adequate and reliable service. Yet, in stark contrast to the manner in which it regulated rates, the FPC did not try to develop a concrete, manageable standard to gauge service obligations. Instead, it relied upon a single unelaborated exhortation to those who control the supply of gas that the public depends upon, to act "prudently." The fluid nature of this "reasonableness" standard simply defies predictability, at a time when a precise, definite standard, with an assured enforcement mechanism is needed. Like the Order in FPC v. Texaco, Inc., Order 539-B is, as written, fatally vague.

Moreover, the FPC subsequently added ambiguity to vagueness, thus further undermining Order 539-B. When it first promulgated the Order, the FPC suggested that the standard was administrable because producers were

"acquainted" with it. However, as the agency came to recognize that the prudent operator standard's origins poorly suited it to the purposes of the Natural Gas Act, the FPC modified its position, and argued that the standard would not, in fact, be the one with which producers were acquainted. Thus, in its brief to the Fifth Circuit, the FPC admitted that "due to public interest considerations," it could not enforce "exactly the prudent operator standard used by a lessor or purchaser." Brief of Respondent Federal Power Commission at 25.

From this condition of vagueness and ambiguity comes Order 539-B's most serious defect -- the utter impossibility of enforcement. Because of its lack of guidance and confusing origins and purpose, the prudent operator standard must defy application. The matter is made worse by the fact that the standard will require an individualized look at the activities of each producer and the conditions in each field. 31/

31/ We do not mean that such factors are irrelevant under a proper standard, but that by starting with a "service" standard the producer would be required to raise these factors in their proper place -- as justification for declining deliveries. See discussion on pp. 48-49, 58, infra.

In reality, such a standard can only result in a few time-consuming and complex proceedings which will exhaust the Commission's limited enforcement resources, without providing the adequate and reliable service the Act was designed to ensure.

In light of the FPC's history in the rate area, the agency's resort to the "prudent operator" standard is all the more disturbing. It was the very impossibility of making a reasonableness determination on a case by case basis that eventually led the FPC to adopt, first area rates, and then national rates for producer sales. See Permian Basin Area Rate Cases, 390 U.S. at 755-59; Shell Oil Co. v. FPC, 520 F.2d 1061 (5th Cir. 1975), cert. denied sub nom. California Co. v. FPC, 426 U.S. 941 (1976). Indeed, it was the backlog caused by individualized scrutiny of producer rates that resulted in what was called in 1960 the "outstanding example in the federal government of the breakdown of the administrative process." Landis, Report on Regulatory Agencies to the President-Elect, printed for use of the Senate Committee on the Judiciary, 86th Cong., 2d Sess., 54. Surely, then, experience has proven that a precise, repeatable and easily applied standard is needed to regulate natural gas producers under the Act.

We would not presume to dictate to the Commission the precise manner in which it must regulate producers' delivery obligations. The Commission has the necessary expertise, as exhibited in a long history of rate regulation. 32/ Although regulating supply may pose problems different from those posed by ratemaking, these problems are surely not insoluble. For example, using the Act's touchstone of service, and a proper reporting 33/ and approval procedure

32/ The agency found a very concrete and unambiguous way to deal with price escalation clauses -- it simply placed an upper lid on them, notwithstanding the producers' objections that the contracts provided no such ceiling. Permian Basin Area Rate Cases, 390 U.S. at 764, 781-84.

The Commission has also made full use of the tools available to it in regulating curtailments of service. See generally, M. Willrich, Administration of Energy Shortages, at 41-108 (1976).

33/ The Commission already receives substantial data from both producers and pipelines. See, e.g., 18 C.F.R. § 260.1 ("Form 2); 18 C.F.R. § 260.7 ("Form 15"); and Order No. 526-C, issued Feb. 17, 1978 ("Form 40"). To the extent that existing reports are not sufficient, the Commission could easily require the pipelines to (footnote continued)

(drawing upon § 4(d), § 4(e), and § 7(b) of the Act), the agency could devise an effective mechanism for monitoring declines in producer deliveries. Applying its expertise, the Commission should be able to develop a workable system of review, tailored to the realities of its limited manpower and designed to place a minimum burden on the industry. It might decide, on the basis of historical trends, that declining supplies within a certain range should be automatically approved and that its attention should focus only on those situations where the data flow indicates that a producer has been experiencing "abnormal" declines. Similarly, it might decide to focus its resources principally on the largest producers.

Clearly, then, there are manageable solutions in the supply arena.

(footnote continued)
submit additional data that would make it possible to trace over time deliveries received under each certificated obligation.

Moreover, as we argued before the court of appeals, this data flow, particularly the reserve and deliverability estimates submitted by the pipeline at the time of application and updates thereafter (see n.19, pp. 15-16 supra), could also play a role in establishing the service standard itself.

The Commission could, if called upon to do so, develop a regulatory scheme faithful to the purposes of the Natural Gas Act, reflecting a standard and enforcement mechanism designed to assure that consumers receive reliable service at reasonable rates.

II. THE "PRODUCTION AND GATHERING" EXEMPTION TO THE NATURAL GAS ACT DOES NOT PRECLUDE THE COMMISSION FROM ENFORCING PRODUCER DELIVERY OBLIGATIONS UNDER AN APPROPRIATE STANDARD.

In addressing the jurisdictional question, we do not defend Order 539-B's prudent operator standard. As indicated above, we believe it is illegal for other reasons. However, it is apparent from the history of this proceeding that the industry is prepared to resist on jurisdictional grounds any effort to enforce delivery obligations, whatever the standard or mechanism adopted. 34/ Moreover, while the court of appeals seemed to indicate that enforcement could proceed under a proper standard, Pet. App. A, p. 7a, its opinion neverthe-

34/ See R. 573, 361, 362, 662, 667.

less casts a pall over the Commission's authority in this area. It is thus extremely important for the Court to resolve this issue in such a fashion as to leave no question concerning the Commission's jurisdiction under an appropriate enforcement program.

As discussed above, any company wishing to sell natural gas in the interstate market must obtain from the Commission a certificate of public convenience and necessity. Any company thereafter wishing to change or discontinue service must obtain authorization from the Commission pursuant to § 4(d) or § 7(b). Notably, however, proceedings under those sections are initiated by the company, as it is the company which must seek Commission approval for a change or abandonment of service. But at the time Order 539-B was promulgated, natural gas producers were reducing, and in some cases even abandoning, service without seeking Commission approval. See, e.g., McCombs v. FERC, 570 F.2d 1376, 1379 (10th Cir. 1978), cert. granted, 47 U.S.L.W. 3240 (Oct. 10, 1978). The jurisdictional question which this Court must now decide is whether § 1(b) of the Act leaves the Commission powerless to prevent such action.

It would seem from the very scheme of the Act -- the process of certifi-

cation, with the express requirements of Commission approval of alterations -- that the Commission must have the authority to enforce the obligations it certificates. Moreover, as this Court recently recognized in upholding the FPC's power to order curtailment of service under § 4, "'the Commission's broad responsibilities . . . demand a generous construction of its statutory authority . . .'" and it "must possess broad powers to devise effective means to meet these responsibilities . . . ." FPC v. Louisiana Power & Light Co., 406 U.S. at 642, quoting in part from Permian Basin Area Rate Cases, 390 U.S. at 776. See also FPC v. Texaco, Inc., 417 U.S. at 388-89; United Gas Pipe Line Co. v. FPC, 385 U.S. 83, 89-90 (1966). Surely, the Commission's authority to assure consumers service under the Natural Gas Act is as broad as its authority to curtail that service. Yet it is now suggested that due to § 1(b) of the Act, the Commission cannot effectively exercise this authority.

In the same decision in which this Court upheld the broad power of the Commission to direct curtailment, the Court also grappled with § 1(b) of the Act. See FPC v. Louisiana Power & Light Co., 406 U.S. at 631-41. In that case, a utility company which stood to benefit if the FPC's curtail-

ment authority were narrowly construed, argued that the "direct sales" exemption of § 1(b) prevented the FPC from directing curtailment of its gas. Had the Court accepted the company's argument, the FPC's curtailment program would have been seriously undermined -- to the great benefit of a few fortunate users in some producing states, but to the enormous detriment of the rest of the nation. Recognizing this, the Court rejected the company's construction of the exemption. As in Louisiana Power, the Court is again asked to construe a narrow exemption under § 1(b). This time, however, the construction proffered is not one which merely undermines the Commission's authority to allocate gas supplies. Rather, the argument made is one which could deprive the Commission of the power to ensure the interstate transmission of any supply at all.

The exemption which the producers would use for this task is not the direct sales exemption in question in Louisiana Power, but the "production and gathering" exemption in the same § 1(b) proviso which the Court in Louisiana Power described as follows:

> It is well established that the proviso was added to the Act merely for clarification

and was not intended to deprive the FPC of any jurisdiction otherwise granted by § 1(b). FPC v. Transcontinental Gas Pipe Line Co., 365 U.S. 1 (1961); FPC v. East Ohio Gas Co., 338 U.S. 464 (1950). The House Report on the bill described this second sentence of § 1(b) as follows:

> "The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill." H. Rep. No. 709, 75th Cong., 1st Sess., 3 (1937).

FPC v. Louisiana Power & Light Co., 406 U.S. at 637-38 n.14 (1972).

Clearly, then, the production and gathering exemption was intended to be a very narrow one. See also

Phillips Petroleum Co. v. Wisconsin, 347 U.S. at 679 (1954); Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690-91 (1947); Northern Natural Gas Co. v. State Corp. Comm'n., 372 U.S. 84, 90 (1963) and the cases cited with approval therein. Moreover, this Court has already addressed the applicability of that exemption in a case which, all else aside, should be determinative of the question here. That case is United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965), which distinguished and severely limited the earlier holding of FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498 (1949), upon which producers have relied so heavily throughout this litigation in an attempt to establish narrow limits on Commission authority. 35/ In United Gas Improvement, this Court rejected the argument that the Commission lacked jurisdiction over the sale, by a producer to an interstate pipeline, of leases covering proven and substantially developed reserves of gas dedicated to interstate commerce. The Court determined that the

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35/ See e.g., Brief of Respondent Producers in Opposition to Petitions for Writs of Certiorari, at 6; Brief of Respondents Tenneco Oil Company and Pennzoil Company in Opposition, at 3-8.

Commission's jurisdiction in that case rested on two factors: the leaseholds were substantially developed, and the sale of gas was in interstate, not intrastate, commerce. The same considerations apply in the instant case, since in enforcing certificated delivery obligations, the Commission is dealing with producers whose gas reserves are already dedicated pursuant to § 7, and already flowing in interstate commerce.

The wisdom of this Court's past approach in narrowly interpreting the § 1(b) exemption is illustrated by the present case, where an excessive reading, denying the Commission authority to enforce producer delivery obligations under an appropriate standard, would have practical consequences for both the Commission and the ultimate consumer of natural gas which would frustrate the underlying purposes of the Natural Gas Act. As the Court noted in a similar context, it would leave "[e]very independent producer of natural gas . . . free at a future date, untrammelled by Commission regulation, to reassess whether it desired to continue serving the interstate market." Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 142. See also California v. Southland Royalty Co., 98 S. Ct. at 1961. And, as a result, it would also place at severe

risk an elaborate system of investments and reliance which has been built upon certificated delivery obligations. 36/

How then could the court of appeals have upheld the producers' arguments? Although we do not agree that Order

36/ We assume the producers will make, as they did below, a number of subsidiary arguments, regarding the alleged absence of a regulatory gap and conflict with state law. We leave these arguments largely in the hands of the Commission. Suffice it to say that regulation of production and gathering activity by the producer state is hardly a practicable method for carrying out the unique mandate of the Natural Gas Act. Cf. United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 403 (1965); Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 691 (1947). To this extent a "gap" surely exists. See FPC v. Louisiana Power & Light Co., supra, 406 U.S. at 631, 633, 634. Further, reliance on a checkerboard of varying state regulations could never bring about the comprehensive regulatory scheme contemplated by Congress. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 28 (1961). Lastly, the present case involves no actual conflict between state and federal regulation, and even if it did, the (footnote continued)

539-B contravenes the 1(b) exemption, we nevertheless believe the answer to this question lies in the standard adopted in that Order. The standard reflects no attempt to inquire into the level of service a producer has provided in the past, so as to determine where and when there has been an unauthorized change or abandonment of service. Rather, the standard calls for a direct look at operations in the field, as the first order of business.

To the extent this approach is the source of a jurisdictional problem, it also points to the answer to that problem. By using a standard which looks first to service, the Commission would only need to consider field conditions if and when a producer argued that those conditions justified declining service from dedicated reserves. In this way, any Commission concern over production and

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(footnote continued)
Commission's jurisdiction would not necessarily give way. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963).

gathering activity would be clearly incidental to the Commission's jurisdiction and authority over certificated service.

CONCLUSION

For the reasons set forth above, the decision of the court of appeals should be reversed, and Order 539-B should be vacated and remanded to the Commission so that the Commission may develop a standard governing producer delivery obligations and an enforcement mechanism consistent with the requirements of the Natural Gas Act.

Respectfully submitted, */

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APPENDIX A

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The Natural Gas Act, 15 U.S.C. § 717 et seq., provides in pertinent part:

§ 1(b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.
15 U.S.C. § 717(b).

§ 4(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order spec-

ifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.
15 U.S.C. § 717c(d).

§ 7(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.
15 U.S.C. § 717f(b).

§ 7(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations....
15 U.S.C. § 717f(c).

§ 7(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.
15 U.S.C. § 717f(e).